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Nos. 81 and 82

In the Supreme Court of the United States

OCTOBER TERM, 1946

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

CHENERY CORPORATION, ET AL.

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

FEDERAL WATER AND GAS CORPORATION

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

INDEX

CITATIONS

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OPINIONS BELOW

The opinion of the Court of Appeals (R. 172–80) is reported in 154 F. 2d 6. The findings and opinion of the Commission, which accompanied its order of February 7, 1945 (R. 128), are reported in S. E. C. Holding Company Act Release No.

5584. Earlier opinions of the Court of Appeals and of the Commission which were considered by this Court in its decision reported in 318 U. S. 80 are set forth, respectively, in 128 F. 2d 303 and 8 S. E. C. 893. See also supplemental findings and opinion of the Commission and report of the Commission on the plan of reorganization which are reported in 10. S. E. C. 200.

JURISDICTION

The judgment of the Court of Appeals was entered February 4, 1946 (R. 181). The petition for writs of certiorari was filed April 8, 1946, and was granted May 13, 1946 (R. 184–185). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended, which is made applicable by Section 24 (a) of the Public Utility Holding Company Act of 1935.

QUESTION PRESENTED

Are the Commission's findings, opinion and order of February 7, 1945, consistent with the decision of this Court in *Securities and Exchange Commission* v. *Chenery Corporation, et al.*, 318 U. S. 80?

More explicitly, the question is whether the Commission may, on the basis of its administrative experience in effectuating the policies of the Public Utility Holding Company Act of 1935 and as applied to the facts of a specific case, but without having issued a general regulation, im-

pose requirements designed to prevent the management of a company which is the subject of reorganization proceedings under Section 11 (e) of the Act from profiting from purchases of securities in the course of the reorganization.

STATUE INVOLVED

The pertinent provisions of the Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 803, 15 U. S. C., Sec. 79 et seq., are set forth in the Appendix, *infra*, pp. 59–60.

STATEMENT [1]

(a) *The Relevant Factual Background.*—When this case began on November 8, 1937, Federal Water Service Corporation (Federal) was a public utility holding company registered under the Public Utility Holding Company Act of 1935 and controlling a public utility system of 42 subholding and operating subsidiaries with water, gas, electric and other properties in 13 states and 1 foreign country. Federal had been incorporated in 1926 under the laws of Delaware. Its Class B common stock, which had the voting control, was originally held by Tri-Utilities Company, a public utility holding company. Its preferred and Class A stocks, with limited voting rights, had been issued and sold to the public.

[1] Since the facts are not in dispute we do not make detailed citations to the printed record but refer the Court to the detailed findings set forth in the Commission's opinion (R. 128, *et seq.*).

After Tri-Utilities went into receivership in 1931, the Class B stock of Federal, which had been previously pledged by Tri-Utilities as security for loans, was sold by the bank pledgees to C. T. Chenery, president of Federal, and other officers, directors and employees of Federal and its subsidiaries who had pooled funds to buy the stock at a net cash cost of about $605,249. The purchases were made through Utility Operators Company (Operators), which Chenery and the others had formed to hold the Class B stock and to issue its own capital stock to the various participants in the venture (R. 131–33).

When the Commission's proceeding began, the respondents in Case No. 81 held about one-third of Operators' stock, including approximately 16 percent thereof which was held by Chenery individually and through his personal holding company, Chenery Corporation. The balance of Operators' stock was scattered among approximately 1,700 persons who were for the most part still employees of Federal and its subsidiaries (R. 132).

At the time Federal registered under the Holding Company Act it was in need of a stock reorganization. Its capitalization included $6,893,500 principal amount of 5½ percent debentures; $15,189,039 aggregate stated value of preferred stock (four series); $13,666,733 stated value of Class A stock; and $2,500,000 stated value of Class B stock. No dividends had been paid on any class

of Federal's stocks since 1931 and there were arrearages on the preferred stock of nearly $6,000,000 and on the Class A stock of approximately $7,000,000. The annual dividend requirements on those stocks were about $1,000,000 for each class. An earned surplus deficit which had exceeded $568,000 at the end of 1932 had grown to more than $2,400,000 by the end of 1937, at which time the net deficit in all of Federal's surplus accounts equaled about half the stated value of the Class B stock. The fair value of Federal's investments in its subsidiaries was disclosed to be at least $5,000,000 less than their $35,477,000 carrying value.[2] Because of this capital impairment, dividends could not be paid out of the current income of approximately $712,000 which Federal had received during the two year period 1936–37 (R. 132–34).

In consequence of the dividend arrearages on the preferred and Class A stocks, the Class B stock (which normally carried the entire voting control)[3] had 42.73 percent of the voting power; 44.80 percent of the voting power was held by the Class A and 12.47 percent by the preferred. Since, however, these latter classes were widely

[2] An appraisal report filed by Federal at the time of registration showed the fair value of its investments to be fully $10,000,000 less than carrying value.

[3] Except in special situations, i. e., the creation of liens, the issuance of new prior preference stock, and the election of three of the seven directors.

distributed among approximately 16,000 public stockholders, the Class B stock retained the full working control of Federal and its operating subsidiaries. Because of the similar dispersion of two-thirds of the voting stock in Operators, which held all of Federal's Class B stock, Chenery and the other individual respondents, through their combined one-third interest in Operators, had the ultimate control of the entire system (R. 134, 132).

Federal's financial condition, particularly the capital impairment and inability to distribute current earnings as dividends, had occasioned attempts at reorganization under Delaware law prior to Federal's registration under the Holding Company Act. A plan of October 1936 had been abandoned because it fell afoul of Delaware law in failing to provide for payment of the dividend arrearages. Another plan had been discussed informally with the Commission's staff a few months before Federal registered but was abandoned following adverse criticism of the staff. This second pre-registration plan provided for a pro rata reduction of the capital allocated to each class of Federal's stock. The staff criticism had been directed to the feature that the capital represented by the senior classes was to be reduced far below their respective liquidating preferences (R. 134–35).

Between November 8, 1937, when Federal registered, and March 30, 1940, Federal proposed four plans of rorganization. Each plan was

proposed for the stated purpose of curing the capital impairment and permitting dividends to be paid and, as well, of bringing Federal's capital "in line with the present value of its assets and its earning power and the provisions of" the Holding Company Act (R. 135).

The first two of Federal's post-registration plans were adversely criticized by members of the Commission's staff, whose basic position was that the Class B stock was worthless and that, accordingly, it was objectionable to give that stock any interest in assets, earnings or voting power through a reorganization. The management, on the other hand, insisted that the Class B stock was entitled to participate.[1] The third plan, filed May 11, 1939, was withdrawn by Federal's management in August of that year because the decision of the Delaware Court of Chancery in *Har-*

[1] The management contended that in addition to voting control it was giving up prospects of future value in the B stock in event of inflation. It should be noted, however, that the A stock, senior to the B stock to the extent of $13,666,733.50 of stated value and approximately $11,000,000 of dividend arrearages, was accorded only a marginal participation of about 5 percent under the final plan as approved by the Commission, and Commissioner Healy dissented from approval thereof on the ground that the A stock was entitled to no participation. The issue of whether the A stock was entitled to any participation was similar to that upon which the Commission and this Court divided in the *United Light & Power* case. (See *Otis & Co.* v. *S. E. C.*, 323 U. S. 624). The Commission was unanimous in holding that there was no conceivable basis for participation for the B stock.

ender v. *Federal United Corporation*, 6 A. 2d 618, cast doubt upon the propriety (so far as Delaware law is concerned) of certain provisions of that plan with respect to the deferring of payments of the dividend arrearages on the senior stocks.[5] (R. 136.)

When that decision was reversed by the Supreme Court of Delaware in *Havender* v. *Federal United Corporation*, 11 A. 2d 331, with the holding that preferred dividend arrearages could be eliminated under Delaware law through a statutory merger, Federal's management submitted its fourth plan to the Commission. This plan, filed March 30, 1940, with subsequent amendments, be-

[5] Because of alleged doubts as to the constitutionality of Section 11 (e) of the Act, the company did not seek to avail itself of the reorganization machinery of that Section (R. 65–66; Tr. 1905–1906), whereby the Commission may apply to a federal equity court to enforce a plan without the consents required by state law if the plan is found fair and equitable and necessary to effectuate the provisions of Section 11 (b), and if the company requests such enforcement. When Federal's plans were filed, there existed no judicial precedent for the enforcement of a plan approved by the Commission under Section 11 (e). The constitutionality of Section 11 (e) was not judicially determined until June 15, 1940, in *In re Community Power & Light Co.*, 33 F. Supp. 901 (S. D. N. Y.) Federal itself reserved the right to challenge the constitutionality of all provisions of the Act except the registration provisions (see, e. g., Tr. 26, 516, 794, 1905–1906, 3220–3221). Under the company's self-imposed limitations, the plan could be accomplished only by charter amendments and other devices provided by the laws of Delaware.

The symbol "Tr." refers to the unprinted portions of the Commission's transcript of record to which by stipulation counsel may refer.

came the basis for the Commission orders under review and is referred to herein as the final plan. As filed, the final plan provided for a merger of Federal with Operators and Federal Water & Gas Corporation, a wholly-owned subsidiary of Federal which had few assets and existed primarily to preserve that corporate name for Federal's use. The surviving corporation was to have a security structure consisting of a single class of common stock, in addition to the theretofore outstanding debentures of Federal, not affected by the plan. This new common stock was to be allocated, about 90.7 percent to Federal's public preferred stockholders, about 5.38 percent to Federal's Class A stockholders, and about 3.92 percent in exchange for assets of Operators other than its holdings ~~for~~ of Class B stock of Federal. These assets of Operators consisted of several thousand shares of Federal's preferred stock (acquired prior to November 8, 1937), some of Federal's debentures, and a small amount of miscellaneous assets (R. 136–37).

Throughout the period of staff discussions, hearings and consideration of the earlier plans, a basic divergence in point of view was reflected in the staff insistence that the Class B stock was worthless from an earnings and asset standpoint and not entitled to participate in any plan, while the management was unwilling to go along with any program which would involve its elimination from participation. In the final plan, however, the only provision giving any consideration to

Federal's management for its holdings, through Operators, of Federal's Class B stock, was a requirement that the directors be elected for staggered terms of office. While the Commission's staff had suggested that this provision might prove acceptable, the Commission had not committed itself on the subject. (R. 137.)

At the request of Federal, the Commission on June 29, 1940, issued tentative findings and opinion on this plan. These findings, which were not made public and were available only to the parties, indicated approval of the principal features of the plan but disapproved of the provision for a staggered board and questioned the propriety of permitting preferred stock purchased by the management during the pendency of the reorganization to participate on the same basis as that provided for other preferred shares. (R. 139.)

These management purchases of preferred stock had been made throughout the period of the reorganization proceedings down to the time of issuance of the Commission's tentative findings and opinion. The purchase program had been sponsored by Chenery, who testified that as early as 1938 the staff's attitude toward the B stock had indicated to him the possibility that the management might ultimately lose on that issue and that, accordingly, he had advised fellow officers and employees who held Operators' stock to buy as much preferred stock as they could carry as a "secondary line of defense." Even before the first

plan was filed, however, Chenery and his personal holding company had acquired 2,164 shares of Federal's preferred stock; of this about 600 shares had been bought in the few days immediately before public announcement of the first plan. At the Commission's hearing on the first plan, a stockholder had criticized these pre-filing purchases. Shortly thereafter, Federal's management met and agreed not to buy any stock while negotiations for a plan were pending and as long as the terms of the plan were not publicly disclosed. (R. 137–38.)

Thereafter, until June 30, 1940, when purchases ceased, C. T. Chenery and Chenery Corporation purchased 8,618 shares of Federal's preferred stock and other members of the management purchased 3,789 shares at various times which they deemed to be permissible under their agreement. All of the stock was acquired through brokers in the open market, excepting 2,700 shares which Chenery acquired in a block from a securities dealer upon an exchange for $100,000 principal amount of Federal's debentures. A substantial part of the shares were bought at prices in the middle 20's and for a few shares they paid prices in the middle 30's. Reports of these purchases were filed with the Commission pursuant to Section 17 (a) of the Holding Company Act. (R. 138.)

The preferred shares which Chenery and other members of Federal's management acquired dur-

ing the course of this reorganization proceeding cost in the aggregate $328,347. The final plan, as originally proposed, provided for an exchange of those shares for new common stock of the surviving corporation having an aggregate book value of $1,162,481.[6] The voting power in the new common stock which Federal's management was to obtain for its preferred stock acquisitions was 7.4 percent of the total voting power. In addition Federal's management stood to receive 2.7 percent of the voting power in the surviving corporation for preferred stock acquired prior to the filing of the first plan and for its approximately one-third interest in the several thousand preferred shares and other assets of Operators. In all, the management stood to obtain 10.1 percent of the total voting power in the reorganized corporation. (R. 138–39.)[7]

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[6] This book figure was substantially more than the Commission's estimates of what the new common stock could be sold for initially in the market. The final plan as originally filed assigned the new common stock a par value of $12 per share; as finally approved the plan accorded a par value of $5 per share for the new stock, pursuant to the Commission's request that par value be brought into line with the probable market value of the new stock. On this reduced basis the management would have received for the preferred stock which it acquired during the course of the reorganization new common stock having an aggregate par and probable market value of approximately $395,385 as compared with an aggregate cost of $328,347 for the shares.

[7] The Holding Company Act (Sections 2 (a) (7) and 2 (a) (8) makes 10 percent or more of voting power presumptive of control.

Following the issuance of the Commission's tentative findings and opinion, the hearings on the final plan were reconvened, and Chenery and other members of the management testified extensively as to their reasons for acquiring the preferred stock and conditions under which they had made their purchases. Their testimony, quoted extensively in the Commission's findings and opinion under review, showed clearly a determination on the part of interested members of the management to acquire the stock primarily as a means of preserving their control over Federal and its system and secondarily because of their recognition of the increased investment value which that stock would be likely to have in the future. The stock was considered to be the management's bulwark against the day when they might have to accede to a plan which gave no recognition to the Class B stock. (R. 141–144.)

In view of the provisions of the final plan with respect to the staggered election of directors and for according equal participation to the preferred stock which the management had acquired during the reorganization, the Commission on March 24, 1941, issued its findings and opinions concluding that it could not approve the plan under the pertinent provisions of the Act unless certain changes were made. These comprised a reduction of the par value of the new common stock, elimination of the provision for election of directors to staggered terms, and the framing of some

provision which would accord only a limited participation to the management's reorganization purchases of the Federal preferred stock. As amended, the plan provided that the preferred stock purchased by the management during the course of the reorganization and which was still held by the management, should be surrendered to the surviving corporation for retirement at cost plus 4 percent interest from the dates of purchase to the effective date of the merger. As to the preferred shares which had been acquired and thereafter sold during the reorganization, the plan provided that the management should surrender the profit on such sales less 4 percent interest on the cost. (R. 144–145.)

C. T. Chenery and the other members of the management thus affected by the plan as amended objected to the plan and were allowed to intervene and file briefs on the question. On September 24, 1941, the Commission rejected the management's objections and issued its supplemental findings, opinion and order approving the final plan as amended. On November 7, 1941, the Commission was notified that the plan had been consummated.[8] (R. 145.)

[8] The intervening members of Federal's management voted their stock against the plan in order to protect their rights in the event they should obtain reversal of the Commission's order in judicial review proceedings. They agreed to surrender their stock in the event they should finally lose their review proceedings, and agreed to accept new stock on the same basis as public preferred stockholders if they won, this in lieu of rights to appraisal under Delaware law.

(b) *The First Review Proceeding.*—Following the Commission's approval of the final plan, as amended, the intervening members of Federal's management (the respondents in case No. 81) filed a petition for review of the Commission's order in the Court of Appeals for the District of Columbia under Section 24 (a) of the Holding Company Act. That court, with one Justice dissenting, reversed the Commission's decision with respect to the requirement that the plan accord only limited participation for the preferred shares acquired by Federal's management during the course of the reorganization (128 F. 2d 303 (1942)).

On writ of certiorari this Court expressed disagreement with some of the views of the Court of Appeals but disagreed also with the reasoning on which the Commission had based its conclusion. This Court neither reversed nor affirmed the decision of the Court of Appeals, but remanded the case to that Court with directions to remand it to the Commission for such further proceedings not inconsistent with this Court's opinion as might be appropriate (R. 98, 111).

This mandate and the accompanying opinion of this Court are the crux of the present proceeding before this Court, raising the paramount question whether the subsequent proceedings before the Commission are within the letter and spirit of this Court's decision.

(c) *Proceedings Before the Commission Following the Remand.*—After the remand of the case to the Commission by the Court of Appeals (R. 117), Federal Water & Gas Corp. (Federal Water), the surviving corporation under the plan, filed an application with the Commission for approval of an amendment to the plan to provide for issuance of new common stock of the reorganized company for distribution to the members of Federal's management in respect of the shares of old preferred stock which they had acquired during the course of the reorganization (R. 118). Such new stock was to be issued and distributed to the management *pari passu* with that previously distributed to the public investors. The intervening members of the management joined with Federal Water in asking that this proposed amendment be approved (R. 127). The staff and a holder of common stock of Federal Water who had previously held Federal's class A stock opposed the amendment. Following briefs and oral argument the Commission on April 17, 1944, issued findings, opinion and order denying the application (R. 130). Objections were made thereto and the Commission decided to reopen the proceeding for further argument and suspended the effectiveness of its order (R. 130). Following this further argument the Commission determined to withdraw its findings and opinion of April 17, 1944, and substituted in place thereof its findings, opinion and order of February 7, 1945 (R. 128).

This is the order now under review. Like the withdrawn order of April 17, 1944, it denied the application to amend the plan so as to accord parity of treatment to the preferred stock purchased by the management.

(d) *Judicial Review of Commission's Current Order.*—Federal Water and the members of Federal's management affected by the Commission's order of February 7, 1945, filed separate petitions for review in the Court of Appeals for the District of Columbia (R. 2, 14).* Proceedings in that court were consolidated for record, briefs and argument (R. 183–184). On review the Court of Appeals reversed the Commission's order (R. 172–180).

SPECIFICATION OF ERRORS

The court below erred:

1. In holding that this Court's prior decision precluded the Commission from denying to the

*Since this case was properly before the court below on the petition of the members of the management who are interested in setting aside the Commission's order, the Commission noted, but did not argue, the question whether Federal Water has standing to file a petition for review as a "person or party aggrieved" by the Commission's order, within the meaning of Section 24 (a) of the Holding Company Act. Federal Water's financial interest would be advanced by sustaining rather than upsetting the order. In the previous review proceedings Federal Water intervened, but did not petition for review. The difference between that case and the present one is that our previous order *approved* a plan submitted by Federal with amendments to conform to the Commission's views; here the order under review *disapproved* Federal Water's proposed amendment to the otherwise completely consummated plan.

preferred stock acquired by Federal's management during the course of the reorganization proceeding, participation in the plan on a parity with publicly held preferred stock.

2. In holding that this Court's prior decision precluded the Commission from resting its order denying parity participation for the management-acquired preferred stock upon the Commission's reorganization experience in the light of the undisputed facts in the record and its conclusions of at least potential harms to investors and to the integrity of the reorganization process flowing from the management's purchase program.

3. In holding that this Court's prior decision allowed the Commission to cope with the problem of management trading during the course of a reorganization under the Act solely by general rule, presumably of only prospective application.

4. In substituting the court's judgment and rejecting the judgment of the Commission as to the probabilities of harm to investors and the reorganization process from the stock purchase program of Federal's management.

5. In reversing the Commission's order of February 7, 1945.

SUMMARY OF ARGUMENT

I. The Commission's order is fully authorized by the mandate of this Court in *S. E. C.* v. *Chenery Corporation, et al.*, 318 U. S. 80. The decision of the court below to the contrary is based

upon a partial reading of this Court's opinion. Read as a whole, this Court's opinion merely held that the Commission's original order was not supported by the equity precedents on which the Commission had relied, and that the Commission's determination could not be sustained as an exercise of administrative judgment because the Commission's opinion did not set forth the findings and considerations which would justify its order as an appropriate safeguard for the interests protected by the Act. This Court did not hold intrinsically unsound the argument presented in the Commission's brief for upholding the Commission's order as an exercise of administrative judgment. It deemed this argument inapplicable because not consistent with its understanding of the Commission's opinion. References in the Court's opinion to the Commission's power to deal by a general rule with the problem of management trading during a reorganization under the Act, are, contrary to the decision of the court below, merely illustrative. Other language in the opinion, wholly ignored by respondents and the court below, clearly shows that this Court did not intend to prohibit the Commission from developing an applicable standard of conduct on a case-by-case basis. Our interpretation of the meaning of this Court's mandate and opinion is further supported by a study of the language of the mandate itself, in comparison with the previous opinion and order of the court below.

II. The Commission's present order is fully supported by substantial evidence in the record, as recited in the Commission's findings and opinion. The Commission has now made the findings and disclosed the considerations which it had previously *argued* to this Court as grounds for upholding its original order. The Commission, as an administrative agency expert in problems of reorganization under the Holding Company Act and other statutes, was fully entitled to resort to its administrative experience in interpreting the facts of this case and in drawing its conclusions about those facts. The view of the court below and respondents that the Commission was not permitted to integrate its special experience with the evidence, and the determination of the court below to substitute its different judgment and experience for that of the Commission in its present findings and opinion, are contrary to the well-settled principle that courts will not undertake to substitute their judgment for that of the agency unless there is no rational basis for the agency's determination.

In this case the Commission's findings and opinion exhibit a firm rational foundation for the Commission's order. It viewed the management's stock purchase program in the light of the broad powers of a holding company management under the Act, including its control over the financial, operating and accounting policies of the various companies in the holding company system, and its

power to initiate and shape reorganization proceedings under Section 11 (e). It observed that entering upon such a purchase program creates a harmful conflict of interest because of the resulting temptation, as well as the opportunity, to shape the reorganization proceeding so as to encourage public selling on the market at low prices, and because of the impossibility of giving public security holders, to whom the management owed a fiduciary responsibility, the equivalent of the management's insight into the future course of the reorganization. For these reasons the Commission concluded that it could not, consistently with the fair and equitable and other applicable standards, permit the management to realize their expected advantages from the purchase program, in terms of profit and control.

III. The lower court's conclusion that the Commission could deal with the problem of management trading during the course of a reorganization under the Act only by general rule, presumably operating prospectively, is, in essence, a criticism of the Commission's present order as improperly retroactive. That determination is an oblique attack upon the meaning of this Court's mandate and opinion, which imposed no trammels on the Commission's powers and fully authorized the Commission to reach the result it has reached upon a clear and explicit statement of the administrative reasons justifying that result. As courts and legislatures have long perceived, standards of con-

duct for fiduciaries may properly be established on a case-by-case basis in which liability is necessarily determined after the event. Any other procedure would place a premium on new methods of evading previously announced standards. This Court has been highly cognizant of the need for administrative agencies to deal on a case-by-case basis with novel and complex problems. Here the Commission's order merely denies to petitioners a hoped-for profit on their investment, a result which is necessary if the plan of reorganization is to be affirmatively found fair and equitable and not detrimental to the interests of investors, as required by the Act.

ARGUMENT

I.

THE COMMISSION'S PRESENT ORDER CONFORMS TO THE PRIOR MANDATE OF THIS COURT

The Commission, the court below (R. 174), Federal Water, and Federal's management all agree that the basic issue in this case is whether the Commission's findings, opinion and order of February 7, 1945, are consistent with the decision of this Court in *S. E. C. v. Chenery Corporation, et al.*, 318 U. S. 80. In issuing its present order the Commission construed this Court's opinion and mandate as holding that the Commission's original order, judged solely upon the grounds of judicial equity relied on by the Commission, could not be sustained because the equity decisions upon

which the Commission had relied did not support the interpretation placed on them by the Commission. The Commission accepted this Court's declaration that it was "not imposing any trammels on" the Commission's powers in reexamining the case upon the remand. The Commission understood this Court as holding further that the Commission had broad statutory powers to protect the public against reorganization abuses, and that upon the remand the Commission was free to consider whether, in the light of the Commission's special experience in administering the legislative policies of the Holding Company Act, the trading by Federal's management during the course of the reorganization proceeding created risks of harm to public investors which would warrant a requirement of special treatment for the management-acquired stock designed to prevent the management from profiting from such purchases.

The respondents and the court below construed this Court's opinion and mandate to mean that, absent findings of conscious wrongdoing on the part of Federal's management, the Commission was not authorized to determine by order in the particular case whether it was consistent with the applicable standards of the Act to permit Federal's management to realize a profit through their reorganization purchases. In their view, and on the hypothesis that the Commission could not,

or would not, find fraud or other conscious wrongdoing, the only permissible disposition of this case was a Commission order which would permit Federal's management to realize their anticipated profit—although the Commission might perhaps be free to promulgate a general rule of solely prospective operation which would preclude realization of such profits in future cases.

We set forth below specific references to this Court's opinion which we believe fully support the Commission's interpretation and are wholly inconsistent with that of respondents and of the court below.

A. The starting point of this Court's reasoning is a statement of complete accord with what had been the Commission's major premise, that "officers and directors" of a company in process of reorganization occupy positions of trust. The Court also stated that a "lax view of fiduciary obligations" would not be countenanced. The conclusion that Federal's management were fiduciaries was stated only to begin analysis of the extent of their fiduciary obligations and the consequences of deviation therefrom. (R. 102; 318 U. S. 85–86.)

B. The Commission's opinion was interpreted as predicated upon a rule of law derived from equity precedents (R. 102–104, 106; 318 U. S. 87, 90), and it was held that review would be confined to the grounds upon which the Commission acted, since

> If an order is valid only as a determination of policy or judgment which the agency alone is authorized to make and which it has not made, a judicial judgment cannot be made to do service for an administrative judgment. For purposes of affirming no less than reversing its orders, an appellate court cannot intrude upon the domain which Congress has exclusively entrusted to an administrative agency. (R. 104–105; 318 U. S. 88.)

C. The opinion then holds—

> If, therefore, the rule applied by the Commission is to be judged solely on the basis of its adherence to principles of equity derived from judicial decisions, its order plainly cannot stand. (R. 105; 318 U. S. 88.)

Distinguishing on their facts the authorities relied on by the Commission, the Court concluded "that the Commission was in error in deeming its action controlled by established judicial principles," noting nonetheless that

> Determination of what is "fair and equitable" calls for the application of ethical standards to particular sets of facts. But these standards are not static. In evolving standards of fairness and equity, the Commission is not bound by settled judicial precedents. Congress certainly did not mean to preclude the formulation by the Commission of standards expressing a more sensitive regard for what is right and what is wrong than those prevalent at the time

the Public Utility Holding Company Act of 1935 became law. (R. 105–106; 318 U. S. 89.)

D. The Government had argued that the Commission acted properly and within the purview of its administrative competence because management trading can affect "the timing and dynamics of the reorganization which the management itself initiates and so largely controls." The Court examined this argument in the light of the applicable standards of Section 7 (d) (6) and (e) and Section 11 (e) of the Act and the intimations in the legislative history that Congress intended by these standards to enable the Commission to afford a higher decree of protection to public security holders than had theretofore prevailed in connection with reorganizations (R. 107; 318 U. S. 90). In the light of these standards and the fact that the Act "vests in the officers and directors of a holding company registered under the Act broad powers as representatives of all the stockholders," the Court concluded that "notwithstanding § 17 (a) and (b), therefore, the Commission could take appropriate action for the correction of reorganization abuses found to be 'detrimental * * *'" in the light of "those more subtle factors in the marketing of utility company securities" which induced the evils the Act was designed to correct. (R. 107–108; 318 U. S. 90–92.)

Thus far in the Court's opinion there is no reference to the Commission's rule-making power,

and no intimation that the Court was discussing anything except the proper disposition by the Commission of the pending case. In construing the opinion to mean that the Commission was not free after the remand to consider a disposition, based on statutory standards, which would prevent Federal's management from realizing its anticipated profits, we submit that respondents and the court below have made what the Court has said up to this point largely meaningless.

E. Respondents and the court below predicate their interpretation upon certain references to the Commission's rule-making power which this Court mentioned in examining the Commission's decision in the light of the broad powers which it had concluded to be vested in the Commission. This Court said "that the considerations urged here in support of the Commission's order were not those upon which its action was based," and observed that the Commission had "formulated no judgment upon the requirements of the 'public interest or the interest of investors or consumers' in the situation before it" (R. 108–109; 318 U. S. 92–93). It was in this context that the Court pointed out that an entirely different problem would have been presented "had the Commission, acting upon its experience and peculiar competence, promulgated a general rule of which its order here was a particular application * * *. Nor has the Commission, acting under the rule-making powers delegated to it by § 11 (e), pro-

mulgated new general standards of conduct. It purported merely to be applying an existing judge-made rule of equity." (R. 108–109; 318 U. S. 92–93.)

Neither of these references to the Commission's rule-making power purports to indicate that the Commission could deal with the problem of management trading in the course of a reorganization solely by an exercise of its rule-making power. To read such a meaning into these statements not only ignores practically all of the Court's preceding analysis of the Commission's powers under the Act, as well as the direct context of the Court's remarks, but assumes that the Court, with the provisions of Section 11 (e) of the Act before it, was unaware that the first sentence of this section authorizes the Commission to supervise by *order* as well as by rules and regulations the conditions under which plans are proposed, and that, indeed, under the second sentence the Commission may determine whether a plan is fair and equitable only by "order."[10] Accordingly, we submit that this Court could not have intended to prevent the Commission from deciding this specific case after the remand on the basis of its general ad-

[10] The fact that Section 11 (e) requires the Commission to determine by order whether a plan is fair and equitable and that such determination, as this Court noted "calls for the application of ethical standards to particular sets of facts," means that this Court was not then faced with the problem which later divided it in *Addison* v. *Holly Hills Fruit Products, Inc.*, 322 U. S. 607, as to the propriety of

ministrative experience evolved and applied in the case-by-case procedure clearly contemplated by Section 11 (e)."

Corroboration of the Commission's interpretation of this Court's references to the Commission's rule-making powers is found, we submit, in the concluding paragraphs of the opinion (R. 110–11; 318 U. S. 93–95)—paragraphs which respondents and the court below have wholly ignored. In these paragraphs this Court restated its conclusion that the Commission's original order could not be upheld on the basis of judge-made rules of equity, and declared that the Court could not assume for itself the Commission's duty of determining whether the management's activities were detrimental to investor interests or unfair and inequitable in contravention of the standards of Sections 7 and 11 of the Act. Speaking negatively—because the Commission had not stated the necessary findings and considerations—this Court indicated that the

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remanding a case for consideration by the agency of the desirability of adopting a rule operative retroactively in an area in which the agency is limited to acting by rule. See *infra* p. 51 *et seq.*

[11] Compare *F. C. C.* v. *Pottsville Broadcasting Co.*, 309 U. S. 134, 145:

"On review the court may thus correct errors of law and on remand the Commission is bound to act upon the correction. * * * But an administrative determination in which is imbedded a legal question open to judicial review does not impliedly foreclose the administrative agency, after its error has been corrected, from enforcing the legislative policy committed to its charge."

Commission's order might have been upheld if findings had been made and considerations disclosed "which would justify its order as an appropriate safeguard for the interests protected by the Act." Thereafter, in the penultimate paragraph of its opinion, this Court declared that the basis of its action was to correct the Commission's misconception of the law and to require, in the interests of the orderly functioning of the process of review, that "the grounds upon which the administrative agency acted be clearly disclosed and adequately sustained" (R. 110–111; 318 U. S. 94–95). Citing and quoting from *Phelps Dodge Corp.* v. *Labor Board*, 313 U. S. 177, 197, language which was stated to be "equally applicable here," this Court declared that it did "not intend to enter the province that belongs to the" Commission and that "all we ask of the [Commission] is to give clear indication that it has exercised the discretion with which Congress has empowered it. This is to affirm most emphatically the authority of the" Commission. Further stressing the limited extent of its decision and the broad powers intended to be left to the Commission upon the remand, this Court stated (R. 111; 318 U. S. 95):

> In finding that the Commission's order cannot be sustained, we are not imposing any trammels on its powers. We are not enforcing formal requirements. We are not suggesting that the Commission must justify its exercise of administrative discretion in any particular manner or with

> artistic refinement. We are not sticking in the bark of words. We merely hold that an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained.

These concluding words of this Court are, as we see it, completely robbed of meaning if the view of the respondents and the court below were to obtain. On their theory the mandate of this Court was in substance merely an affirmance upon different grounds of the lower court's original decision, which had plainly left the Commission no recourse but to allow Federal's management to participate equally with all other stockholders with respect to the preferred stock acquired by the management during the reorganization proceeding. But it is clear that this Court's mandate was not one of affirmance of the Court of Appeals. On the contrary, this Court directed the Court of Appeals to remand the case to the Commission "for such further proceedings, not inconsistent with this opinion, as may be appropriate." (R. 111; 318 U. S. 95.) Such a mandate, we submit, was in harmony only with an opinion which, having corrected errors of law on the part of the Commission, but disagreeing with the earlier ruling of the Court of Appeals that the Commission was required to accord parity treatment to the management holdings of preferred stock, sent the case back to the Commission

for reexamination as an exercise of administrative judgment.

II

THE COMMISSION'S PRESENT FINDINGS AND OPINION DISCLOSE A RATIONAL AND COMPETENT EXERCISE OF ITS ADMINISTRATIVE DISCRETION IN THE APPLICATION OF THE STATUTORY STANDARDS

In its present findings and opinion the Commission has amplified the administrative considerations which had been presented to this Court in the Commission's brief and argument in the first *Chenery* case, and which this Court had held not then relevant because not constituting the disclosed basis for the Commission's original decision. The Commission's present decision makes clear that its basis is the relation of management trading "to the timing and dynamics of the reorganization which the management itself initiates and so largely controls"; the "strategic position enjoyed by the management in this type of reorganization proceeding"; the circumstance that in such a reorganization proceeding there is vested in the management "statutory powers available to no other representative of security holders"; the "more subtle factors in the marketing of utility company securities that gave rise to the very grave evils which the Public Utility Holding Company Act of 1935 was designed to correct"; and questions as to "abuse of corporate position, influence, and access to information * * * so subtle that the law can deal with them effectively only by prohibitions not con-

cerned with the fairness of a particular transaction." (318 U. S. at 90, 92, R. 106, 108, 109.) In its present findings and opinion the Commission has stated that it has derived its conclusions on these matters from the facts of this case and from its general experience in dealing extensively with corporate reorganizations, both under the Act, and other statutes entrusted to it, and from its exhaustive studies of protective and reorganization committees. In short, as an examination of the Commission's present findings and opinion will disclose, the Commission has now made the findings and disclosed the considerations which this Court previously indicated "would justify its order as an appropriate safeguard for the interests protected by the Act." No question is made as to the substantiality of the evidence to support the Commission's subsidiary findings of fact. Indeed, they are based upon undisputed facts. There remains only the question of whether there is a rational basis in law for the Commission's conclusions. Because the opinion of the court below does not, as we see it, adequately set forth the present rationale of the Commission, we call this Court's attention to certain salient aspects thereof.

First, it must be noted that the Commission carefully circumscribed the precise question before it by stripping away "the more general legal question whether corporate managers normally are entitled to realize whatever advan-

tages they may seek by trading in the stock of the corporation they manage" (R. 147), and by indicating the sharp distinction between managerial purchases "while corporate operations were taking their normal course" from those made during the "critical period while the corporation and its subsidiaries were undergoing necessary structural changes" (R. 148). The narrow question left for decision was whether (R. 146)—

> * * * on the record before us it would be consistent with the purposes and standards of the Holding Company Act for us to approve the amended plan as the means by which the interveners may realize the increment, in terms of profit and control, that they expected would accrue to them through their acquisition of preferred shares while this reorganization was under consideration.

In passing upon the plan, the Commission indicated that it was required to determine (1) whether the plan was "fair and equitable" to the persons affected thereby within the meaning of Section 11 (e); (2) whether the terms of the new stock issuance were "detrimental to the public interest or the interests of investors or consumers" under Section 7 (d) (6); (3) and whether the proposed alteration of rights of Federal's security holders would "result in an unfair or inequitable distribution of voting power" or "be detrimental to the public interest or the interest of investors or consumers" within the meaning of

Section 7 (e) (R. 147). It was the Commission's view that positive affirmative findings were required under each of these sections and that with respect to the first question, "if the record leads us to a negative answer, or leaves undispelled doubts generated by any step taken by the management in the reorganization process, we cannot in good conscience make the affirmative finding required to sustain our approval and must accordingly withhold such approval, even if we made no affirmative finding" regarding the second and third questions (R. 147–148).

The Commission's conclusion (R. 149) was that it was unable to find that the plan, as proposed to be amended to allow participation for the management-acquired preferred stock on a parity with publicly held stock, would be "fair and equitable" within the meaning of Section 11 (e). Stated affirmatively it concluded that the plan, if amended, would be "detrimental to the public interest and the interests of investors" and would result in an unfair and inequitable distribution of voting power contrary to the requirements of Sections 7 (d) (6) and 7 (e). The Commission declared itself led to this result by the character of the conflicting interests created by the management's program of stock purchases carried out while plans of reorganization were under consideration.[12] The Commission therefore refrained

[12] "Doubts, inevitably suggested by the existence of these conflicting interests, remain unresolved • • •." (R. 149.)

from making the required affirmative statutory findings of approval.

As reasons for its conclusions, the Commission first pointed out the powers of a holding company management in a voluntary reorganization under Section 11 (e), contrasting the management's functions in that mode of reorganization with those of a management in a Chapter X reorganization where an independent trustee has been appointed to control, under the aegis of the court, the supervision of the business and the framing of the plan of reorganization (R. 152). In view of the management's preeminent powers in a reorganization under Section 11 (e) of the Holding Company Act, bearing in mind all of the management's stake in securities, compensation, and other perquisites of both profit and prestige, the Commission deemed it necessary to exercise fully for the protection of investors the powers which Congress had given it to supervise the reorganization process in order to eliminate detrimental practices in reorganization and, in the words of the committee report, to "make it impossible for a group of favored insiders to continue their domination over inarticulate and helpless minorities, or even, as is often the case, majorities." S. Rep. No. 621, 74th Cong. 1st Sess. p. 33 (R. 152).

The Commission found that Federal's management controlled a large multi-state utility system and in that system occupied over a hundred

directorships, 35 presidencies, 25 vice presidencies, and six treasurerships, that one member of the management was chairman of the boards of 11 companies, that one of them was general counsel for 17 companies, and that a third was a consulting engineer for 16 companies. With respect to Federal itself, the Commission found that the present individual respondents before this Court included three directors, the president, six vice presidents, the secretary and the treasurer. (R. 153.) Permeating the entire system in this way, Federal's management could obviously, in the normal course of operations, influence the entire system down to the lowest tier of operating companies. Through their control over the financial, operational, and accounting policies of the parent and its subsidiaries, they determined whether and when subsidiary earnings should be drawn up into the holding company or withheld, and it was possible for them to obscure earnings within the accounts of the subsidiaries. (R. 153.) The Commission found that exercise of such powers can affect the corporate income of the holding company, can reduce or increase an impairment of capital, and ultimately can affect the holding company's ability to pay dividends. Furthermore, such activities, coupled with control of timing and presentation of plans, can affect the market prices of the holding company's outstanding securities among the various classes of security holders and even their respective participations in a reorgan-

ization under the Act. (R. 153–154.)[18] The Commission pointed out that the broad range of business judgments vested in a holding company's management—because of the pyramided nature of the enterprise—multiplied opportunities for manipulation and made the exercise of judgment on any matter a subject of greatest significance to investors (R. 154–155).

The Commission also referred to the control of the holding company management over refinancing of subsidiaries in the sale and rearrangement of subsidiary properties, frequently having substantial effect upon the flow of earnings to the top company (R. 155). The Commission commented upon some of the subsidiary reorganizations, refinancings and transfers in the Federal system which were taking place during the course of the reorganization of Federal and which indicated "the far-reaching functions of the holding-company management during the reorganization period." The Commission pointed out further that certain of the subsidiary rearrangements necessarily affected its consideration and determination of the fairness of Federal's plan. (R. 140–41.)

Added to all these corporate managerial powers,

[18] Such determinations are based largely on earnings records, and those records may be affected by management decisions whose manipulative intent often cannot be discovered without an investigation into the state of the management's mind (R. 153–154, 160–161.)

the Commission found, as this Court had previously pointed out, that a holding company management obtained special powers in the course of a voluntary reorganization under Section 11 (e) of the Holding Company Act (R. 155; 318 U. S. 80, 91). These special powers derived in part from the circumstance that under Section 11 (e) the management was representative of all the stockholders, initiated the proceeding, drew up and filed the plan, and could file amendments thereto at any time. Because of its representative status the management had special opportunities to obtain advance information of the attitude which the Commission's staff might take as to pending plans or future proposals when such plans should be brought before the Commission (R. 156).

The Commission's experience indicated to it that all these normal and special powers of the holding company management during the course of the reorganization under Section 11 (e) placed in the management's command "a formidable battery of devices that would enable it, if it should choose to use them selfishly, to affect in material degree the ultimate allocation of new securities among the various existing classes, to influence the market for its own gain, and to manipulate or obstruct the reorganization required by the mandate of the statute." (R. 156.) It was in such a setting that the Commission was required to consider the hazards of a managerial program of purchasing stock

for profit and control purposes during the course of the reorganization proceeding.[14]

As the Commission stated, "If, in this setting, the management enters upon a stock purchase program there is inevitably the temptation, as well as the opportunity, to shape the reorganization proceeding so as to encourage public selling on the market at low prices. Public announcements by

[14] The Commission recognized of course that conflicts of interest might often prevail between management and one or more classes of its security holders, where, as frequently is the case, the management predominantly represents the interests of one class, usually the common stockholders who normally elect the management to office and in which class the management often itself has a financial interest. But that conflict, the Commission pointed out, was a normal and unavoidable attribute of any extra-judicial reorganization where the plan was not formulated by an independent representative of all classes. In consequence, that conflict could be anticipated. (R. 157.)

It was the Commission's view, however, that the conflict ceased to be normal or unavoidable when members of the management undertook to obtain personal advantage out of the reorganization by engaging in a program of buying its outstanding securities for the purpose of obtaining either voting power or an enhanced value which the management expected those securities to have in the reorganized corporation. At that point, the Commission declared, "any management, no matter how honorable, makes its own motives suspect. Indeed, once it enters upon such a program even its acts prior to reorganization are compromised in retrospect because for all practical purposes it is impossible for anyone, attempting at a later time to trace back and sort out the motives that guided such action, to reach a firm conclusion that managerial judgment was not in at least some respects exercised in contemplation of the personal gain to be realized ultimately from the reorganization." (R. 157–58.)

the management can be directed to that end. Steps can be taken that may delay and protract the proceedings in such a manner as to make senior stockholders lose hope of receiving dividends within a reasonable time and induce some of them to sell out at a sacrifice." [15]

No management, the Commission found, could engage in such a program without raising serious question as to whether its personal interests had not opposed its duties "to exercise disinterested judgment in matters pertaining to subsidiaries' accounting, budgetary and dividend policies, to present publicly an unprejudiced financial picture of the enterprise, and to effectuate a fair and feasible plan expeditiously." [16] The natural in-

[15] The Commission noted that "many unsupervised reorganizations have been accomplished by first stopping dividends and starving the non-voting preferred stock to the point of desperation, then wielding the voting power of the junior stock as a weapon to force ultimate reorganization on terms unduly favorable to the latter. The management of a holding company is in a peculiarly strategic position to know the meaning of the non-payment of dividends, and what can be done to remove blocks in the flow of earnings from subsidiaries." (R. 156, note 24.)

[16] The management's determination to withdraw the Third Plan because of *Havender* v. *Federal United Corporation*, 6 A. 2d 618 (Del. Ch. 1939) and its determination not to attempt to put through a plan in a federal court proceeding under Section 11 (e), thereby overriding the state law restriction presented by the *Havender* case, illustrate the broad powers exercised by Federal's management as reorganization managers (R. 65–66, 136). We do not say they were improper decisions; we cite them solely as examples of powers actually used. The testimony of Mr. C. T. Chenery

clination of any person to buy cheaply, coupled with the normal and extraordinary powers of a holding-company management to further that objective by creating the conditions which make cheap buying possible during the course of a reorganization before us, are bound to create a risk—perhaps in some cases merely potential but in all cases very real—of harm to all of the company's public security holders whether or not they elect to sell." (R. 158.)

If there were proof that reorganization managers had engaged in such a program of buying in the stock at bargain prices intentionally created or maintained by their own acts, the Commission could not properly find a plan fair and equitable which allowed the managers to retain those inequitably obtained benefits. It was the Commission's view, however, that the answer should not be substantially different even though proof of intentional wrongdoing was lacking in a particular case. The construction of normal powers and unique powers under Section 11 enjoyed by Federal's management in the operation of the system, and the ways in which such powers were exercisable led the Commission to conclude that "absence of unfairness or detriment in cases of this sort would be practically impossible to

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quoted in the Commission's opinion shows that the management acted with full understanding of its power to make litigation an alternative to negotiation (R. 143).

establish by proof. * * * Questionable transactions may be explained away, and an abuse of investors and the administrative process may be perpetrated without evil intent, yet the injury will remain." (R. 161.)

Turning then to the record in the present case, the Commission pointed out that the salient fact was that Federal's management had as its primary object in buying the preferred stock "the voting power that was accruing to that stock through the reorganization, and * * * profit from their investment therein" (R. 161). That stock, the Commission observed, had been purchased in the market at prices which were depressed in relation to what the management anticipated would be, and what in fact was, the earning and asset value of its reorganization equivalent. Considering the management's justification of its motives in operating the business of the system and formulating the plans of reorganization, the Commission concluded that the management was merely endeavoring to "deny that they made selfish use of their powers during the period when their conflict of interest, *vis-a-vis* public investors, was in existence owing to their purchase program." (R. 163.) Further, it was the Commission's opinion that Federal's management, having undertaken this program, had placed itself in a position where it was "peculiarly susceptible to temptation to conduct the reorganiza-

tion for personal gain rather than the public good," and, consequently, that program insofar as it depended upon making *advantageous* purchases of stock "could have had an important influence—even though subconsciously—upon great numbers of business decisions all along the way" (R. 163).

Considering the management's necessarily superior knowledge, the Commission concluded further that it was not possible, as a practical matter, for management to give the stockholders generally enough of that superior knowledge to enable the stockholders to form an independent judgment on the question whether or not they should sell and at what price.[17] For this reason, said the Commission, the traditional concepts of "honesty, full disclosure, and purchase at a fair price" could not be the controlling tests, however controlling they might be when applied by courts to dealings in normal course between corporate managers and stockholders (R. 164).[18] Those

[17] The management, after all, was under a fiduciary duty in the reorganization to represent all the company's stockholders, including those from whom the managers were purchasing stock.

[18] The Commission in its present opinion has explained the wholly argumentative meaning which it had intended to convey by the so-called "admissions" of fair dealing on the part of Federal's managers, as referred to in this Court's prior opinion (R. 164). What the Commission meant in its original opinion, and what its counsel in briefs and argument upon review had assumed, was merely that the inflex-

tests could not be determinative of the Commission's problem, "which is to be fully satisfied that the plan of reorganization is fair and equitable, and not detrimental in the particular circumstances bearing upon the acquired stock *vis-a-vis* the stock of public investors." [18a]

Thus the Commission rested not only on the ground that undiscoverable abuse may have occurred, but that, in some respects, abuse was in-

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ible rule of equity on which it originally relied did not even permit inquiry into the question whether the transactions of the reorganization managers here were characterized by "honesty, full disclosure and purchase at a fair price."

It should be noted that the opinion of the court below not only ignores the Commission's explanation of why it actually made no findings whatever on the subject of the good or bad faith of Federal's managers, but instead emphasizes again and again, without any foundation in the record, what it terms affirmative findings that "petitioners' purchases of stock were in all respects fair, honest and aboveboard, resulting neither in any unjust enrichment to themselves nor harm to other stockholders or the public" (R. 174), and that "the result was neither unfair nor inequitable to the persons affected by the plan" (R. 174). See R. 174–177. The Commission has made no such findings.

[18a] As this Court declared in *Virginia Electric & Power Co.* v. *N. L. R. B.*, 319 U. S. 533, 543:

> "It is * * * wrong to fetter the Board's discretion by compelling it to observe conventional common law or chancery principles in fashioning such an order, or *to force it to inquire into the amount of damages actually sustained.* Whether and to what extent such matters should be considered is a complex problem for the Board to decide in the light of its administrative experience and knowledge." (Italics supplied.)

evitable as a result of the purchase program. In this category, for example, belongs the Commission's conclusion that full disclosure to selling stockholders would require the management to do the impossible job of bringing the investor up to its own level of sophistication and knowledge about the system, the course of internal negotiations, the attitude of the staff and the future intentions of the management (R. 163).[19]

The respondents have not challenged either the facts in the record or the validity of the conclusions which the Commission drew from its general experience in administering the Act. The court below, however, objected to the Commission's use of its administrative experience by describing the Commission's judgment as to the probability of harm to investors without proof of

[19] Obviously the extensive negotiations between Federal management and the staff which occurred in the instant case gave the management an insight beyond that available to the public preferred stockholders to whom the management owed fiduciary obligations but from whom it was purchasing stock. For example, the management would have realized that any plan which would meet Commission approval would probably require denial of participation to the B stock and would accord a more valuable participation to the preferred stock than reflected in the earlier proposal of the management. Yet public security holders may well have looked to management proposals as an indication of the participation they might expect. The management possessed similar advantages of inside information arising out of negotiations with the staff with respect to the relative participation of the preferred stock which the management was purchasing and the class A stock in which the management had no interest.

wrongdoing in the particular case as a "rule of fiat" and as a decision based upon "an unsupported suspicion," "unresolved doubt," and "weaknesses or selfishness which the Commission believes is inherent in human nature." (R. 178–179.). We submit, however, that there was substantial evidence to support the Commission's decision in the undisputed facts and that the Commission could properly view this evidence from the vantage point of its special experience with reorganization abuses. Indeed, the Commission's failure to base its original decision upon such administrative considerations seems to have been a motivating factor in this Court's first opinion.

The Commission was entitled to conclude from its experience that the management's persistent efforts to obtain participation for the worthless Class B stock, its attempts to salvage some control through the device of electing directors to staggered terms, and its purchases of preferred stock at depressed prices for the admitted purpose of preserving its control over Federal and its system, as well as in the expectation of profits through the plan, created hazards harmful to investors and to the integrity of the reorganization process. Similarly, the Commission was not bound to infer from the management's post-hoc testimony that the conflicting interests so created had not in fact affected its judgment as to the proper exercise of its broad powers over the reorganization and that no harm had in fact resulted.

In insisting that the Commission could not rely upon its administrative experience the court below was in essence making respondents' difficulty of controverting, in the review proceedings, the Commission's administrative judgment a ground for precluding the exercise of that judgment (R. 178–179). In so holding the court below overlooked, however, this Court's prior intimation that "abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions not concerned with the fairness of a particular transaction." (R. 109; 318 U. S. 92.) In addition, this criticism by the court below and the respondents represents the same groundless attack upon the Commission's powers which this Court rejected in the analogous case of *Republic Aviation Corp.* v. *N. L. R. B.*, 324 U. S. 793. There, it will be recalled, the order of the Labor Board holding improper discharges of employees for solicitation of union membership in violation of the employers' non-soliciting rule was decided by the Labor Board as a case to which general considerations evolved from its administrative experience were fully applicable.[20] The argument of the employer, like that used by the court below in

[20] The quotations from the Labor Board's opinion which appear as footnotes to this Court's opinion in the *Republic Aviation* case show a marked similarity of approach to that adopted by the Commission in the present case.

reversing the Commission's present order, was that the Board could not use its knowledge of industrial relations in lieu of proof of conscious wrongdoing in the particular case. As this Court declared, in rejecting that contention, "One of the purposes which led to the creation of such boards is to have decisions based upon evidential facts under the particular statute made by experienced officials with an adequate appreciation of the complexities of the subject which is entrusted to their administration." (324 U. S. at 800.)

What the court below lost sight of in its condemnation of the Commission's decision is that there was ample room for judicial review of the Commission's findings in the present case—or would have been if respondents had seriously challenged either the substantiality of the evidence, so far as the findings of fact are concerned, or "the rationality between what is proved and what is inferred." See *Republic Aviation Corp.* v. *N. L. R. B.*, 324 U. S. 793, 805. See also *Virginia Electric & Power Co.* v. *N. L. R. B.*, 319 U. S. 533, 543.

The Commission's duty to apply to the facts of this case conclusions drawn from its broad administrative experience comes close to the heart of the whole administrative process and reflects one of the chief reasons for the creation of administrative agencies. This Court in its earlier opinion recognized the special experience

of the Commission in the reorganization field (R. 108; 318 U. S. 92).[21]

While respondents have not challenged the appropriateness of the Commission's choice of remedy insofar as limiting the management to cost plus four per cent interest with respect to the stock acquired during the course of the reorganization, we believe we should point out that the remedy chosen was similar to that adopted by Congress in Section 17 (b) of the Holding Company Act and Section 16 (b) of the Securities Exchange Act. These provisions allow corpora-

[21] That the Commission had the background requisite to exploring the problem in this case and to form a seasoned judgment about it is evident not only from the Commission's experience in administering the Holding Company Act but, as well, from its contact with reorganization problems, generally, in the performance of its duties under Chapter X of the Bankruptcy Act and under the Investment Company Act and in conducting the investigations and studies reported to Congress in the protective committees report and the investment companies report. See Bankruptcy Act of 1938, §§ 172, 179, 190, 208, 222, 247, 265a (11 U. S. C. §§ 572, et seq.); Investment Company Act of 1940, § 36 (15 U. S. C. § 80a–35); S. E. C. Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (1937–1940), Parts I–VIII; Report of the S. E. C. on Investment Trusts and Investment Companies (1938–1942), Parts 1–5. It was in view of the Commission's unique experience in the reorganization field that this Court declared in its prior decision that the Commission "accumulates an experience and insight denied to others" and that the Commission's administrative determination "must not be set aside because the reviewing court might have made a different determination were it empowered to do so."

tions to recover management profits from short-term trading in the corporate securities. It is likewise the remedy adopted by Congress in Section 212 of Chapter X of the Bankruptcy Act for the purpose of preventing reorganization managers under the Act from profiting from security transactions during the course of a reorganization thereunder. See S. Rep. No. 1916, 75th Cong., 3rd Sess., pages 33–34. Furthermore, the question of the appropriate remedy, like the problem of what formal inferences are to be drawn on the basis of admitted facts, is one on which this Court has held that the administrative judgment must stand unless clearly erroneous. See *Phelps Dodge Corp.* v. *N. L. R. B.*, 313 U. S. 177, 194–95; *Virginia Electric & Power Co.* v. *N. L. R. B.*, 319 U. S. 533, 539–43; cf. *Gemsco* v. *Walling*, 324 U. S. 244.

III

THE COMMISSION WAS ENTITLED TO FORMULATE THE STANDARD APPLIED IN THIS CASE BY ORDER AND WAS NOT LIMITED TO ACTING BY A GENERAL RULE

In passing on Fede[redacted]s plan the Commission was dealing with a particular case involving a particular plan which could be passed upon only by *order* and only after the Commission had determined whether, in that case, it could or could not find that plan "fair and equitable." No general rule of any type whatever could have avoided the necessity for acting by order in relating that

rule to the facts of the particular case. Since the only benefit which the respondents could have obtained from a pre-existing general rule would have been *foreknowledge* that their purchases might ultimately be held improper, the only consequence of the absence of such a rule in the decision of this case is to raise a question of possibly improper retroactivity. It is a question of retroactivity which lies at the base of the lower court's holding that the Commission, in dealing with the problem of management trading in a voluntary reorganization under the Act, could rely on its administrative experience only in the formulation of a general rule. (R. 175, 179, 180.)

Of course some element of retroactivity is involved in the application of any standard, legal, equitable or ethical, to particular sets of facts. This is so whether a jury is applying a standard of due care, a court of equity is applying equitable principles governing the conduct of fiduciaries, or the Commission is giving content to the "fair and equitable" standard of the Holding Company Act. But that kind of retroactivity, which is inherent in the Commission's present order, is not the type of retroactivity which the law condemns. Indeed, in *Phelps-Dodge Corp.* v. *N. L. R. B.*, 313 U. S. 177, *Republic Aviation Corp.* v. *N. L. R. B.*, 324 U. S. 793, and *Virginia Electric & Power Co.* v. *N. L. R. B.*, 319 U. S. 533, the administrative

remedies sanctioned by this Court all contained substantial elements of similar retroactivity.

The mere fact that administrative agencies, unlike courts, may have the power to lay down rules applicable to future cases as well as the power to decide particular cases before them, should not limit the agencies to the use of a rule in every case of first impression. The consequence of respondents' argument in that vein, as expressed in the lower court, would, we submit, substantially impair and, indeed, hamstring the work of every administrative agency with power to make general rules as well as specific orders. Every order not based on the letter of the statute or on all-fours with a prior decision would then be open to the novel challenge that the agency should have acted by rule, no matter how well founded was the order in the intent of the law. Such a requirement for the adoption of general rules in advance of every step forward in the agency's effectuation of statutory policies would go far to defeat the intention of Congress of promoting flexible administrative machinery for the very purpose of allowing the agencies to use varied facilities to cope with the specialized problems before them. As the Report of the Attorney General's Committee on Administrative Procedure in Government Agencies points out:[22]

[22] S. Doc. No. 8, 77th Cong., 1st Sess., p. 29.

> * * * administrative agencies, like the courts, must often develop their jurisprudence in a piecemeal manner, through case-by-case consideration of particularized controversies. This is so partly because the full variety of circumstance can infrequently be perceived in advance. Partly, too, it is necessitated by the circumstances of the agencies' creation. Often an agency has been entrusted with responsible duties in an area in which experience is yet to be won, and where premature rigidifying of policies may prove to be harmful in the extreme. Sometimes, moreover, it is the very justification of an administrative agency's existence that it may exercise discretion in dealing with individual problems which are difficult to fit within the too inflexible boundaries of rules.

In the context of this case retroactivity is a false issue. The real area of dispute here is simply whether the specific considerations brought to bear on the issues by the Commission can fairly be said to be inherent in applying the standards and policies of the Act. If they are, we submit that there is no improper retroactivity but merely implementation of the statutory command. This court expressly found that the Holding Company Act provided a firm basis for the power employed by the Commission in this case (R. 107–108; 318 U. S. 90–92) and in so doing, we submit, eliminated any real issue of improper retroactivity.

While the first sentence of Section 11 (e) does authorize the formulation of prospective rules as well as orders, it is mandatory that the Commission act by order in determining whether a plan is "fair and equitable." Assuming for purposes of argument that the Commission should have had the foresight to formulate a rule upon the subject prior to the date of the respondents' purchases, surely that lack of foresight should not be held to obliterate its subsequent responsibility to decide this particular case in the light of applicable statutory standards. To have so concluded would, as the Commission declared, "give the intervenors a premium for risking the interests of the public investors, to the detriment of the latter, and, as well, to the detriment of investors in many other holding company securities, and of the public interest, within the meaning of Sections 7 (d) (6) and 7 (e)." (R. 166.) If holding company managements, in spite of their positions of trust in respect of pending reorganizations were free, in absence of express prohibitions, to pursue their personal advantage despite conflicting interests and risk of harm to public security holders, mere lack of foresight by the Commission would permit the "lax view of fiduciary obligations" which this Court "rejected." (R. 102; 318 U. S. 85).[23]

[23] In consequence, the safeguards which Congress hoped to accomplish through "Commission approval of reorganization plans and supervision of the conditions under which such

Furthermore, as the Commission pointed out in its opinion, Federal's management was not "acting wholly in a legal vacuum" when it bought the preferred stock of Federal, and could reasonably have anticipated the possibility of challenge to their purchase program (R. 164). As the record showed, criticism had actually been voiced at the early hearings with respect to the management's pre-registration purchases of preferred stock and the management had given partial acknowledgment of the validity of the criticism by mutually agreeing not to purchase before plans were publicly announced.[24] In addition, the provisions of Section 77B, as augmented in 1938 by Sections 212 and 249 of Chapter X, indicated that there was at the time of the management's purchases a "climate of opinion" condemning and penalizing similar practices in a related field.

In sum, the Commission's approach to the problem was that of carefully, judiciously weighing the mischiefs of a contrary course of action. See *Addison* v. *Holly Hill Fruit Products, Inc.*,

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plans are prepared" would be impeded and the Commission would be unable to prevent "a group of favored insiders [from continuing] their domination over inarticulate and helpless minorities, or even, as is often the case, majorities * * *." (S. Rep. No. 621, 74th Cong., 1st Sess., p. 33.)

[24] The record shows there was some deviation from this policy, perhaps unintentional, and that some members of the management had differing ideas of what was a proper time to purchase shares (R. 46, 49, 51–53, 54–57, 60–62, 64–67, 70–71, 75–76, 144).

322 U. S. 607, 622.[25] Since the Commission and not the court below had the responsibility of deciding whether to restrict itself to laying down standards applicable to future cases or whether it should apply the fair and equitable standard to limit the management's purchases to cost in this case, we submit that the reversal of the Commission's order by the court below was an im-

[25] Viewing the problem as one of administrative discretion, we freely concede that under some circumstances it may be appropriate for the administrative agency to limit itself to announcement of future policy or the prescription of a rule applicable to future cases. Respondents in the court below urged that "the Commission now is well aware that prohibitions involving the promulgation of new policies should be prospective in their operation," citing in this connection the Commission's decision in *Western Light and Telephone Company*, Holding Company Act Release No. 5902 (July 2, 1945), where a policy to preclude participation in competitive bidding on the part of a person employed as financial adviser by the issuer was announced for the future, although not applied to the particular case. An earlier instance might have been cited. See *El Paso Electric Co.*, 8 S. E. C. 366, 377–78 (1940), where reliance upon the existence of prior Commission decisions which might have been considered to have reached a contrary result was held to justify non-application of the newly announced standards in the pending case. To the same effect, see *Mississippi River Power Company*, Holding Company Act Release No. 5776, pp. 27–28 (May 4, 1945). Of course, the Commission recognizes that under some circumstances it is appropriate to follow such a course. But, for the reasons indicated in the text, the Commission's determination in the present instance to decide the case before it reflects a rational administrative judgment which should not be overturned upon review.

proper substitution of that court's judgment for the judgment of the Commission.

CONCLUSION

For the foregoing reasons, the judgment of the court below should be reversed and the order of the Commission should be affirmed.

Respectfully submitted.

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APPENDIX

Section 7 (d) (6) of the Public Utility Act of 1935 (49 Stat. 803, 15 U. S. C. § 79, *et seq.*), in pertinent part, provides:

> If the requirements of subsections (c) and (g) are satisfied, the Commission shall permit a declaration regarding the issue or sale of a security to become effective unless the Commission finds that—
>
> * * * * *
>
> the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interest of investors or consumers.

Section 7 (e) provides:

> If the requirements of subsection (g) are satisfied, the Commission shall permit a declaration to become effective regarding the exercise of a privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security unless the Commission finds that such exercise of such privilege or right will result in an unfair or inequitable distribution of voting power among holders of the securities of the declarant or is otherwise detrimental to the public interest or the interest of investors or consumers.

Section 11 (e) provides:

> In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors

or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

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